

**1. Financial Statements**

**1.1 Opinion**

The audit of the financial statements of the National Savings Bank. (the “Bank”) and the consolidated Financial Statements of the Bank and its subsidiaries (the “Group”) for the year ended 31 December 2022 comprising the statement of financial position as at 31 December 2022 and the income statement, statement of comprehensive income , statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with provisions of the National Audit Act No. 19 of 2018 and Finance Act No. 38 of 1971. My comments and observations which I consider should be report to Parliament appear in this report.

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Bank and the Group as at 31 December 2022, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

**1.2 Basis for Opinion**

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

**1.3 Responsibilities of Management and Those Charged with Governance for the Financial Statements**

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards, and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Bank and the group’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intend to liquidate the Bank and the group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank and the Group’s financial reporting process.

As per Section 16(1) of the National Audit Act No. 19 of 2018, the Bank and the Group are required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared of the Bank and the Group.

#### **1.4 Audit Scope**

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank and the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Conclude on the appropriateness of the management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank and the Group's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Bank and the Group's to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

The scope of the audit also extended to examine as far as possible, and as far as necessary the following;

- Whether the organization, systems, procedures, books, records and other documents have been properly and adequately designed from the point of view of the presentation of information to enable a continuous evaluation of the activities of the Bank and the Group, and whether such systems, procedures, books, records and other documents are in effective operation;
- Whether the Bank and the Group have complied with applicable written law, or other general or special directions issued by the governing body of the Bank.
- Whether the Bank and the Group has performed according to its powers, functions and duties; and
- Whether the resources of the Bank and the Group had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

**1.5 Audit Observations on the preparation of Financial Statements.**

**1.5.1 Internal Control over the preparation of financial statements.**

**Audit Issue**

A high risk towards the accuracy of the financial statement was observed due to manual intervention in the financial statement preparation process. Two main Trial Balances (TB) are being prepared separately for Branches and for the Head Office. Trial Balances of all branches are abstracted from CBOS system and convert it to MS Excel spread sheet format and create a single Trial Balance for branches. Trial Balances of Head Office divisions are taken separately and amalgamated in to a single TB for Head office. Finally, by using both Trial Balances, financial statements are being prepared. This might lead to loss or manipulation of data. Therefore, the bank needs to evaluate the necessity of fully automated system solution to prepare the full set of financial statements to ensure the data accuracy.

**Management Comment**

Currently, Branch General Ledger and Head Office General Ledger are maintained as separate computerized G/L systems. However, necessary controls are in place to ensure the capturing and recording of the transactions to individual G/L systems when there is a manual intervention for the transactions. All the trial balances are generated through the G/L systems and MS Excel Spread Sheets are used to prepare the Financial Statements (FS) of the Bank and relevant controls are in place to ensure the accuracy of the FS. The profit appeared in Excel FS is reconciled and 100% tally with the profits recorded in the G/L system before the closing of the financial year and accordingly the accuracy of FS is maintained. Further, the implementation of Core Banking solution has already started to overcome the manual intervention of the current system.

**Recommendation**

Manual interventions in preparing financial statements should be minimized.

## 1.5.2 Unreconciled Control Accounts or Records

Item	Management Comment	Recommendation
<p>The inter branch balance as at 31 December 2022 amounted to Rs.103,260,737 and the corresponding amount in the preceding year amounted to Rs.407,412,355. This balance has been derived by accumulating several numbers of Branch ledger and Head office ledger accounts. Some of these balances were freeze balances since several years ago. However, no any procedure had been implemented by the bank to reconcile these inter branch account balances.</p>	<p>The following procedures are in place to reconcile the inter branch balances.</p> <p><u>Manual HO Our Account</u></p> <p>Reconciliation statements are being prepared by the branches on monthly basis to monitor the balances for the clearance.</p> <p><u>Automated Head Office Our Accounts</u></p> <p>Comparison of inter branch balances are prepared monthly basis and regular meetings are conducted to monitor the balances for the clearance including settlement accounts.</p> <p>The inter branch balances recorded in 2021, Rs. 407,412,355 has now being reduced to Rs. 103,260,737 in 2022.</p>	<p>Sufficient and adequate Procedures should be implemented to reconcile the Inter branch balances.</p>

## 1.6 Non-compliance with Laws, Rules, Regulations and Management Decisions etc.

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
a)	National Savings Bank Act, No.30 of 1971 - Section 47	Payments made by the Bank to customers through the Unclaimed Deposits Reserves Account should be reimbursed from the consolidated fund of General Treasury. However, out of Rs.1,035 million paid to customer until the end of 2022, a sum of Rs.570 million had not been reimbursed even up to the date of 31 July 2023.	A request has already been made for the recovery of the balance. Bank should comply with the requirement of NSB Act.
b)	Compliance Requirements as per Banking Act Direction	As per the relevant directions, the primary responsibilities of the Company Secretary shall be to handle the secretariat	At the 3 <sup>rd</sup> meeting of the present Board dated 24.05.2023, this requirement has been Bank should comply with the relevant sections of the Banking Act

<p>No. 12 of 2007.</p> <p>Section 3(1) (vii) (ix) and 3(1) (x)</p>	<p>services to the board and shareholder meetings and to carry out other functions specified in the statutes and other regulations. As well the company secretary should maintain the minutes of board meeting and there is a process for directors to inspect such minutes. However, some instances were observed that the board has held meetings by avoiding Board Secretary's presence.</p>	<p>emphasized and assured the same will not be occurred.</p>	<p>Direction No.12 of 2007.</p>
<p>Section 3 (2) (iv)</p>	<p>Although the Board should have at least three independent non-executive directors or one third of the total number of directors, whichever is higher, only two independent non-executive directors were appointed for the Board during the year 2022 and all other five directors are designated as non-independent and non-executive directors.</p>	<p>This requirement has been informed to the appointing authority (Secretary to the Treasury) in three instances dated 21.12.2022, 31.01.2023 and 21.07.2023 by the Secretary to the Board.</p>	<p>Bank should comply with the relevant section of the Banking Act Direction No. 12 of 2007.</p>
<p>Section 3.2 (i) and 3. 2 (ix)</p>	<p>As per Section 8 (1) (a) of the NSB Act No. 30 of 1971, appointments of Directors are carried out by the Minister of the relevant Ministry. However, actions have not been taken to appoint Board of Directors for the period of four months from January to April 2023. All functions of the Bank had been carried out in the absence of the Board of Directors during the above mentioned four months period and new appointments had taken place in May 2023.</p>	<p>This requirement has been informed to the appointing authority (Secretary to the Treasury) in three instances dated 21.12.2022, 31.01.2023 and 21.07.2023 by the Secretary to the Board.</p>	<p>Bank should comply with the relevant sections of the Banking Act Direction No. 12 of 2007.</p>

		The Bank was unable to meet the minimum requirement of Directors during the period from January to April 2023 and therefore non-compliance with Section 3.2 (i) of the Corporate Governance Direction was observed.	
Section 3 (6) (ii) (a)		Although the Chairman of the Board Audit Committee should be an independent non-executive director, the Chairperson of the bank's Audit Committee was non-independent director due to holding a chairmanship of the Board Audit Committee of a subsidiary of the Bank.	This requirement has been informed to the Board by Secretary to the Board on 12.05.2022 and Secretary to the Board will remind the same at the next appointment. Bank should comply with the relevant section of the Banking Act Direction No.12 of 2007.
Section (3)(6)(iv)(f)		Although the Nomination Committee shall be chaired by an independent director and preferably be constituted with a majority of independent directors, the Chairman and even the majority of the committee consisted from non-independent directors.	Requirement will be informed to the appointing authority at the time of appointing and reappointing of Directors by Secretary to the Board. Bank should comply with the relevant section of Banking Act Direction No. 12 of 2007.
c) Public Enterprise Circular No. 01/2020 of 27 January 2020		Although, Chairman of any State-Owned Enterprise (SOE) will be entitled to use only one official vehicle and a fuel allowance equivalent to 150 liters per month, the former Chairperson of the Bank had used two vehicles and claimed 4,401.64 liters of fuel from National Savings Bank and 1,800 liters of fuel from Sri Lanka Savings Bank (SLSB) during the year 2021 by exceeding the limits stipulated through the Circular.	Chairperson of the Bank participates in Bank's savings promotional campaigns and therefore travels through the branch network covering the entire island. Also, she travels to Colombo from Kandy which is her hometown. Further, Chairperson uses CAT 1972 with an engine capacity of 2982 CC which is 6 years old, and the fuel consumption is Bank should comply with the relevant Circular Instructions given by the Department of Public Enterprise (PED).

very high. The other vehicle in the pool i.e. KU 8117 is also over 10 years old which is used by the Chairperson in case the CAT 1972 cannot be used due to service, repair and maintenance. The fuel consumption of KU 8117 is also very high.

d) Public Enterprise Circular No. 03/2016 of 29 April 2016

The Bank had paid Pay as You Earn (PAYE) tax/ Advance Personnel Income Tax (APIT) from its own funds according to the collective agreement, instead of being deducted from respective employee's salary. Payment details of last five years are as follows.

According to the collective agreement PAYE/APIT was paid by the bank until 31<sup>st</sup> December 2022 and however, with effect from 01.01.2023, PAYE tax is deducted from the salaries of the respective employees.

Bank should not bare PAYE tax/ Advance Personnel Income Tax (APIT) on behalf of its employees.

Year of Assessment	Amount (Rs.'Million)
2016/2017	155.15
2017/2018	157.11
2018/2019	125.75
2019/2020	146.8
2020/2021	11.8
2021/2022	30.44
2022/2023 (Up to 01 January 2023)	42.99

e) Direction No. 3 (6) iii (d) of the compliance requirements of the Corporate Governance and Paragraph No. 2.1 (d) of

Although, the CEO should not present at meetings of the committee, when matters relating to the CEO are being discussed, General Manager had attended for the meeting held on 05 April 2022 which had taken a decision to keep General

The minutes of the BHRRC meeting held on 05.04.2022 do not mention whether the General Manager was present or not when this matter was taken up. However, the minutes of

Bank should comply with the Corporate Governance Directions and TOR of the BHRRC.

the “Terms of Reference” (TOR) of the BHRRC of the Bank.

Manager’s salary at the maximum salary step of the relevant range.

the Board Meeting held on 25.04.2022 have mentioned that the General Manager had excused himself when this matter was taken up.

f) As per the section 3.1 (ii) of the Operational Manual for State Owned Enterprises issued by the Department of Public Enterprises General Treasury dated 16 November 2021.

Although, it was mentioned that State Owned Enterprises (SOEs) which are under collective agreement for deciding remuneration including state owned banks shall seek concurrence of the General Treasury for their salary revision, the Board of Directors had granted its approval to place, the present General Manager’s salary on the 5th salary step (maximum step) of the salary scale of general manager category with effect from the date on which he was promoted to the post of General Manager of the Bank and to pay arrears accordingly at their meeting held on 25 April 2022 without getting concurrence of the General Treasury. Therefore, extra salary of Rs.6,375,840 was paid to the General Manager with the salary arrears until the month of April 2023.

The section 3.1 (ii) of the Operational Manual for State Owned Enterprises, stated as **Shall seek concurrence of the General Treasury for their salary revision.**”

The Board of Directors has not made any salary revision to the General Manager. The Board has made only the placement of the General Manager’s salary on the 5<sup>th</sup> step of the existing salary scale. Accordingly, it is not required to obtain the concurrence of the General Treasury and the Board of Directors had taken this decision as per the Section 26 (3) of NSB Act.

Further, the Board at its meeting held on 25.04.2022 had unanimously arrived at this decision in which the Treasury Representative on the Board from the Ministry of Finance also had attended.

Salary steps approved by the General Treasury should not be changed without concurrence of the Treasury.

## 2. Financial Review

### 2.1 Financial Result

The operating result of the year under review amounted to a profit of Rs. 2,529 million and the corresponding profit in the preceding year amounted to Rs. 22,119 million. Therefore, a deterioration amounting to Rs.19,590 million of the financial result was observed. The reason for the deterioration was the decrease of net interest income by Rs. 22,166 million.

During the year 2022, total interest income of the Bank had increased by Rs.41,502 million or 31 percent due to increase of interest received from loan and advances, debt and other instruments and interest receivable from treasury. The total interest expenses for the year under review had been increased by Rs.63,669 million or 82 per cent due to increase of interest paid for depositors.

### 2.2 Trend Analysis of major Income and Expenditure items

Analysis of major income and expenditure items of the year under review compared with the preceding year with the percentage of increase or decrease are given below.

Description	Variance Amount Increase/ (Decrease) (Rs. '000)	Variance %	Reason for the Variance
Net Interest Income	(22,166,660)	(41)	Increase of interest expenses on due to depositors by Rs. 61,056 million mainly due to increase of interest rates.
Net Fee and Commission Income	(902,762)	(32)	Decrease of fee and commission income generated from loan related services.
Net Other Operating Income	(103,791)	(20)	Dividend income had decreased by Rs. 138.58 million.
Impairment Charges	(557,754)	(13)	Impairment provision for loans and advances had been increased by 76 percent or Rs.2,279 million which is mainly due to increase in loans categorized under stage 3 due to adverse economic impact prevailed in the country.
Total Expenses	2,120,373	11	Office administration and establishment expenses and Contribution to Defined Benefit Plan had been increased by Rs.1,003 million and Rs.973 million respectively

## 2.3 Ratio Analysis

According to the information made available, certain important ratios of the Bank for the year under review and the preceding year are given below.

Description	Sector Ratio*	Bank	
		2022	2021
<b>Profitability Ratio</b>			
Return on Equity (ROE)	2.3	3.40	33.92
Return on Assets (ROA)	0.1	0.28	1.93
Interest Margin	2.8	2.03	3.71
<b>Assets Quality Ratio</b>			
Stage 3 loans to total loan ratio (Net of impairment)	11.3	2.82	2.54
<b>Capital Adequacy Ratios</b>			
CAR-Tier I ratio (Minimum 8%)	14.2	15.78	18.60
Total CAR ratio (Minimum 12%)	17.7	18	20.83
<b>Liquidity Ratio</b>			
Liquid Assets Ratio (Minimum 20%)	30.9	40.62	59.63

\*Sector ratios were extracted from the information published by Central Bank of Sri Lanka

The following observations are made in this regard.

- (i) The Return on Equity (ROE) Ratio and Return on Assets Ratio (ROA) of the Bank had been decreased by 30.52 percent and 1.65 percent respectively in the year 2022 as compared with the preceding year.
- (ii) The Liquidity Assets Ratio had decreased by 19.01 percent when compared with the preceding year and it was above the industry average of 30.9 percent.
- (iii) Total Capital Adequacy Ratio of the Bank had decreased by 2.8 percent as at 31 December 2022 and stand at 18 per cent which is higher than the minimum statutory requirement of 12 percent.
- (iv) Net interest margin of the Bank in 2022 had decreased by 1.68 percent as compared with the preceding year. However, interest margin of the year under review is considerably lesser than the industry interest margin of 2.8 per cent. The reasons for lesser interest margin was the increase of interest expenses by a greater percentage than the percentage increase of interest income of the Bank.

Interest expense was increased mainly due to customer's moving from low yielding to high yielding fixed deposits during the year 2022. Interest Income was increased by lower percentage compared to the interest expense due to inability of the bank to reprise the lower interest rates of loans and advances granted by the Bank on fixed term. As well there was no repricing of the investment made in long term Treasury Bond which were made at lesser interest rate by

complying with the statutory requirement of NSB Act of investing 60 percent of bank's deposits in government securities.

#### 2.4. Analysis of Staff Costs

- (i) It was observed that, though the Bank had incurred a cost of Rs.3.05 million per employee per year, the profit generated per employee was only Rs.0.56 million for the year 2022. However, other banks had reported more than Rs.2.33 million profit per employee during the year 2022.
- (ii) Personal Expenses as a percentage of Net Operating Income of the Bank was 47.6 percent for the year 2022 which represented highest value comparing to other state banks during the year under review.

Description	National Savings Bank	People's Bank	Bank of Ceylon
No of Employees	4528	7377	8209
No of Branches	262	745	581
Cost Per Employee (Rs.million)	3.05	3.61	3.53
Profit Per Employee (Rs.million.)	0.56	2.33	3.89
Personal Expenses as percentage of Net Operating Income	47.6	34.61	32.36

### 3. Operational Review

#### 3.1 Identified Losses

##### Audit Issue

The total loss occurred to the Bank from 89 numbers of fraudulent activities as at 31 December 2022 was Rs.58.37 million and it has increased to Rs.60.56 million as at 31 May 2023 from 95 number of activities. Out of them, Rs.41.47 million of losses were older than five years period. Fifteen (15) numbers of fraudulent cases, which brought total loss of Rs. 87.24 million to the Bank had been done by staff members and outstanding balance of those losses were Rs.46.89 million or 77 percent from the total loss of Rs.60.56 million as at 31 May 2023. Forty-nine (49) numbers of cases are ATM cards related frauds which were occurred during the years of 2021, 2022 and 2023. Out of them, 38 numbers

##### Management Comment

- Rs.37 million out of Rs.41 million over five years frauds are related to pending court cases.
  - Out of the total outstanding of Rs.46.89 million of frauds done by staff members as at 31 May 2023, Rs.37 million were related to pending court cases.
  - Investigations are pending for 38 out of 49 cases related to ATM.
- The following actions have been taken to strengthen the internal control mechanisms of branch operations.
- Senior Deputy General Manager's Instruction Letter No. 453/2017 dated June 13, 2017, Deputy

##### Recommendation

Bank should implement sufficient internal controls over branch operations to avoid fraudulent activities and monitor them continuously.

of frauds, valued at Rs.3.22 million were done by a third party by doing online shopping through the card related information hacked from the Payment App. Any insurance claim had not been received for those 38 numbers of fraudulent cases related to hacking up to the date of audit on 31 May 2023.

General Manager’s Instruction Letter No. 569/2019 dated October 21, 2019 and Senior Deputy General Manager’s Instruction Letter No. 637/2023 dated August 28, 2023 have been issued to emphasize the critical importance of strict adherence to all relevant manual, circulars, circular letters and instruction letters. These documents have been identified as being violated within branch operations as highlighted in audit reports.

- Instructions have been issued to the Regional Managers to conduct regular visits and closely monitor branches to ensure that all branch operations align with the prescribed internal control measures.
- Administration Division /Branch Management Division continuously following up fraudulent withdrawal account and necessary actions are taken to clear the balances.
- An adequate provision of Rs. 57.6 Mn has been made for the possible losses of fraudulent withdrawals (after adjusting for the possible recoverable amount)

### 3.2 Management Inefficiencies

Audit Issue	Management Comment	Recommendation
(a) Although it has been taken more than 07 years so far, the Bank has failed to complete the Core Banking Solution Project which was initiated since April 2016 at an estimated cost of USD 13,015,224 (revised - without taxes) and USD 5,117,654.05 had been spent up to now. Spending such a longer time period to implement this kind of	The Bank commenced the procurement process for the procurement of a core banking solution in April 2016 and the procurement process was completed in April 2019 with the approval of the Cabinet of Ministers to award the tender to Temenos AG/Temenos Headquarters SA. The core banking system	It is required to take every possible effort to complete the Technological Applications like Cor-Banking System within a reasonable time period.

highly technological application may lead to obsolete the system at the end amidst the other banks in the industry are embracing the latest technologies constantly.

Project implementation commenced only from October 2019 and after completion of business requirements gathering workshops, the consultants of main implementation partner left the country due to COVID-19 pandemic and they could not return to Sri Lanka until September 2021 due to international travel restrictions which directly impacted the delay in completion of project activities. Further, additional time has to be allocated due to inclusion of Loan Origination and some other modules as per the requirements of the Bank and change of rollout approach from 5 Branches to Big Bang approach.

Further, the progress of project activities was adversely impacted due to unrest situation in the country from April to August 2022 as consultants working on-site left country due to security reasons.

Initial estimated time frame for the implementation of core banking solution was 18-24 months and according to the initial Master Project Plan, the Project was to be completed in 2<sup>nd</sup> quarter of 2021.

In view of minimizing the impact on project timelines due to COVID-19 pandemic and other changes, the Project activities were carried out simultaneously. Accordingly, Analysis, design and build stages have been completed except for 2-3 interfaces. Both SIT and UAT testing activities are being carried out in parallel.

Even though it has been planned to go-live by the end of September 2023, the target could not be achieved due to further improvements required for data

migration and performance testing/turning. And critical interfaces such as CEFTS, Internet Banking, SLIPS, Payment App could not be completed as planned, optimizing Close of Business (COB) process and bugs related to Loan Origination and AA Lending modules which were released for in August 2023.

The Bank is implementing the latest version of the core banking solution available at the time of finalization of business requirements i.e. in 2021. Therefore, latest functions and capabilities of the core banking system are available for the Bank.

(b) Following observations are made regarding the Risk Management Function of the Bank.

(i) Several instances were observed that the Board and the top management have disregarded the recommendations and comments given by the Risk Management Division (RMD). Though the RMD has clearly identified risks involved with some major loans through their risk assessment reports, the Credit Committee and the Board had approved to grant such loans without considering highlighted risks. Some of those loans were categorized as Non-Performing Loan as at 31 May 2023. Three of such major loans granted to borrowers are given below.

The Board and the Top Management always consider the Risk reports submitted by the Risk Division which is very important to evaluate and make a sound credit decision. All credit papers especially these reflecting big values and all corporate facilities are submitted to the Risk Management Division to table their opinion to the Credit Committee. Both the Credit Committee recommendation and the Risk report along with the board paper are being submitted to the Board of Directors for their approval. However, in some instances, the Board and the Management have taken certain decisions considering other factors such as an opportunity for the Bank to venture into lending, diversifying the Investment Portfolio of the Bank, the opportunity to earn a higher rate of return, the nature and importance of the project for the economic development of the country etc. Nevertheless, the action will be taken not to repeat the lapses identified in the report in future.

Bank should pay attention to Risk related Recommendation and comments highlighted by the Risk Management Division before approving loans to the commented customers.

<b>Borrower</b>	<b>Granted Year</b>	<b>Granted Amount (Rs.' Mn)</b>
RPI (Pvt) Ltd (Maldivian Company)	2018	1.806 (USD 9 Mn)
Property loan (60308627 7552)	2020	164.73
Techno Park Development Co. (Pvt) Ltd	2021	750

Total outstanding balances of those three loans as at 31 May 2023 were Rs.3.791 million, Rs.164 million and Rs.750 million respectively.

(ii) The Risk Management Division (RMD) of the Bank has conducted Root Cause Analysis since the year 2018 for selected loss events and attention of the relevant parties were drawn for taking necessary actions to minimize recurrences. However, similar fraudulent activities of the Bank's staff were observed continuously. Therefore, it revealed that, the attention has not been given by the relevant parties to implement the given recommendations by the RMD.

The Branch Management Division ensures strict compliance with essential Circulars related to internal controls, including the General Manager's Circular 769/2010 and many other. The Branch Management Division (BMD) has also issued various other Circulars and Instruction Letters addressing operational root causes of the previous fraud incidents. These Circulars serve as comprehensive guidelines to our branches, emphasizing the importance of adhering to robust internal control practices to safeguard against potential risks and fraud. Following Instruction Letters have been issued in order to address root causes of frauds identified after 2018. (instruction letters of DGM (operation)- 569/2019 dated 21.10.2019, 469/2018 dated

To prevent continuous fraudulent activities, bank should implement strict policies and actions against those reported incidents.

18.10.2018, and 649/2022 dated 09.02.2022 instruction letters of Senior DGM-535/2019 dated 05.03.2019 and 483/2018 dated 09.03.2018)

Continuous Branch Inspections

To further strengthen internal controls, the Regional Managers conduct continuous branch inspections in addition to detailed audits and surprise audits conducted by the Internal Audit Division. Despite physical branch inspections being limited due to the impact of the COVID-19 pandemic in 2020 and 2021, we ensured continuous awareness sessions through online platforms to maintain vigilance and compliance with internal control procedures. Instructions Letter dated 20.06.2023 had been issued addressing Regional Managers as an action of further strengthening continuous branch inspection activities.

While the BMD has issued necessary instructions to address operational issues, some frauds were found due to the system issues/limitations. Therefore, the IT division has been informed to introduce some control in the system.

(c) Although the Bank had spent Rs.83.6 million for the construction activities on lands situated at Anuradhapura, Elpitiya, Galnewa, Katharagama, Kirindiwela, Moneragala, Ratnapura and Kekirawa, during the period from 1973 to 1996, the legal ownership of those lands had not been taken even as at the end of the year 2022.

Bank is in the process for sign the lease agreements by discussing with relevant authorities and land commission.

Bank should take lease hold right for above lands within reasonable period of time.

(d) As per the confirmation received from branch managers, 425 numbers of loan files relating to granted loans

All Regional Managers have been instructed to monitor the missing loan

Internal controls over file management should

of Rs.328,969,565 were misplaced as at 30 April 2023. The misplaced loan files include 134 personal loan files, 272 housing loan files, 10 legal files and 9 loan files granted against fixed deposits. Following observations are made in this regard.

- (i) Out of these 425 numbers of misplaced loan files, 30 percent or 126 number of loan files were related to loans under non-performing category. Out of those, 30 files are related to Housing Loans, 95 files are related to Personal Loans and one file was a Loans against deposits. Total outstanding amount of those Non-Performing Loans as at 30 April 2023 was Rs.50,325,463 which represented 66 percent of the total granted amount.
- (ii) Out of 425 numbers of misplaced loan files, ten numbers of loan files with aggregated outstanding balance of Rs.2,766,086 were legal files. Due to misplacement of these files, the bank could not take legal actions against borrowers and deed of customers cannot be released after recovering the loans. This may impair the good image of the Bank in long run.
- (iii) Out of 425 numbers of misplaced loan files, 254 number of loan files or 59 percent were misplaced in Kaduwela branch due to flooding situation. Out of these,

files monthly.

The Credit Committee will be updated of the same on quarterly basis.

The latest position of missing loan files is as follows.

be strengthen in every branch.

35 number of loan files are relating to loans under non-performing category. The total outstanding balance of these loans were aggregated to Rs.16,266,596.

- (iv) The missing loan files in Head Office branch was 24 and out of that 20 loan files were under non-performing housing loan category from which 16 files were related to fraud done by a staff member of that branch. The possibility of taking legal actions against the staff member who committed frauds is questionable due to unavailability of loan files.

### 3.3 Operational Inefficiencies

#### 3.3.1 Loan Disbursements

Audit Issue	Management Comment	Recommendation
<p>a) Total outstanding balance of the corporate loans as at 31 December 2022 was Rs.90,191.55 million and out of that Rs.5,908.13 million was under nonperforming category. This total outstanding balance had been increased to Rs.90,445 million at the end of May 2023 and out of that, Rs.5,730 million was categorized under non-performing category. Out of the above non-performing loan balance, 66 percent represents foreign loan and 29 percent represents loans granted to two government related companies which was secured by treasury guarantees.</p>	<p>The captioned foreign loan has been referred to the Attorney General Department to seek advice / concurrence in pursuing legal action to recover the loan.</p> <p>The two-government related NPL refers to National Water Supply &amp; Drainage (NWSDB) Board and Technopark</p>	<p>The Bank should perform proper customer evaluations before granting loans and take every endeavor to recover the loan outstanding.</p>

Development  
Company Pvt Ltd  
(TDC).

NWSDB – The  
arrears amount  
was subsequently  
settled by  
NWSDB on  
28.07.2023 and  
28.08.2023.

TDC - The Bank  
kept informed the  
Secretary,  
Ministry of  
Finance of the  
NPL situation and  
requested  
assistance in  
resolving the  
matter.

Director General,  
Department of  
Public Enterprises  
by letter dated  
21.06.2023

informed the Bank  
that the matter has  
been referred to  
Director General,  
Department of  
Project  
Management and  
Monitoring and  
Secretary,  
Ministry of  
Investment  
Promotions.

The Bank  
contacted the  
Secretary,  
Ministry of  
Investment  
Promotion and  
requested a

b) Outstanding balance of over 5 million loans granted by the bank as at 31 May 2023 was Rs.23,338 million. Out of the total outstanding, Rs.22,151 million or 95 percent was granted via branches and remaining 5 per cent was granted via the credit division. The loans aggregating to Rs.10,136 million or 45.7 per cent granted through branches and Rs. 1,062 million or 89.5 per cent granted via credit division were categorized under non-performing loan category as at 31 May 2023.

meeting to discuss the matter with the respective officials. A meeting date is yet to be provided.

Due to the extraordinary economic conditions that prevailed in the country in 2021/2022, higher policy interest rates were maintained as a measure to control high inflation, which led to an increase in loan installments. This occurred in a context where the cost of living rose significantly. These factors created an environment that is susceptible to loans becoming nonperforming. Additionally, the Central Bank of Sri Lanka (CBSL) imposed various restrictions on regular loan recovery actions, which lasted until the end of 2022, starting from the COVID-19 pandemic period. However, the

The Bank should perform proper customer evaluations before granting loans and take every endeavor to recover the loan outstanding and minimize the Non-Performing Loan Balance of the Bank.

Bank has implemented the following measures to establish a proper monitoring and control mechanism for nonperforming loans (NPLs).

- The top 100 NPL customers of the Bank are being continuously monitored by the Recoveries Division and necessarily follow up activities has already been initiated.
- A dedicated loan recovery center was established on March 1, 2023, at Beliatta, in addition to the existing Head Office Recovery Division which report to Head office.
- Deputy General Manager's instruction letter 674/2023, dated March 13, 2023, was issued under the title "Concessionary Measures to Borrowers" to facilitate loan

rescheduling and restructuring as a means to control nonperforming loans (NPLs). This initiative aligns with the CBSL's letter dated March 2, 2023.

- The Deputy General Manager (Operations) introduced appropriate system measures through letter No. 684/2023, dated May 23, 2023, to be employed in the fully settlement of NPLs.
- Instructions have been issued to expedite the issuance of Letters of Demands (LODs) for non-performing loans (NPLs), including those for which legal actions were temporarily suspended due to CBSL guidelines.
- Measures have been implemented to provide monthly progress reports on NPL recovery steps taken by the

Branches to the Board of Directors.

- A mobile phone App has been introduced to follow up new NPL loans with effect from August 2023 which App facilitates the Staff to follow-up the newly categorized loan accounts to minimize the NPLs.

c) The Bank had granted a joint property loan amounting to Rs.164,730,000 on 23 December 2020 for two persons. Following observations are made in this regard.

- (i) The Bank had not done a proper customer evaluation to verify the income sources of borrowers to ensure the recoverability.
- (ii) At the initial stages, the Board and Credit Committee had disagreed to grant the loan due to unfavorable status of the CRIB and the businesses of the borrowers. However, the Board had given their approval to grant the above loan without considering CRIB arrears and Decreasing Term Assurance (DTA) policy from customers, extending the repayment period from 15 years to 20 years and by exceeding the loan to value ratio of 75 percent through a special board meeting held on 9 September 2020.
- (iii) Two Board Directors including treasury representative who opposed to approve the said loan had not been invited for the above-mentioned special meeting. However, the above meeting had been held with the participation of one of the borrowers. Hence, the transparency of the board decisions is questionable.

H.M.R.C.S. Rajakaruna & G.E.N.M. Ekanayake – The Board has granted approval to auction the property and recover the loan. The Board resolution was published on three newspapers and the government gazette on 27.09.2023. A tentative auction date has been set to 14.11.2023.

The Bank should perform proper customer evaluations before granting loans and take every endeavor to recover the loan outstanding and minimize the Non-Performing Loan Balance of the Bank.

(iv) The borrower had paid only two installments and 27 installments valued at Rs.39,363,397 were in arrears. Total outstanding balance of the loan as at 31 May 2023 was Rs.164,008,906.

d) A syndicated loan amounting to USD 10 million had been granted by National Savings Bank and Peoples Bank to a Maldivian company named as RPI Private Limited on 14 June 2018. The NSB had contributed for USD 9 million which is 90 per cent of the total loan. The borrower had not paid any capital repayment or any arrears interest of USD 2.93 million which was outstanding as at 31 May 2023. Following observations were made in this regard.

- i) The aforesaid loan was granted to a foreign company which is operating under tourism industry for the purpose of a construction and this does not cover under the scope specified in the NSB Act.
- ii) No evidences were observed to prove whether the bank has done comprehensive credit evaluation or risks assessments of the customer prior to granting the loan.

(i) According to Bank should the Section 6 (g) participate for of the NSB Act, syndicated loans the Bank is within the scope authorized to specified in the participate in the NSB Act. syndication of loans with other banks and financial institutions.

Further, approval Comprehensive of the Central credit evaluation Bank of Sri Lanka should be done by and the necessary the bank before legal clearance of granting this type Legal Division of of facility. NSB was obtained prior to granting the loan.

iii) As per the General Manager's Circular No.1641/2015 on Post Loan Review Mechanism, the bank has not reviewed the

(ii) Bank perused Monthly

credit facility within 3 months of approving the loan. However, as per the internal memo dated 22 January 2019 from AGM (Risk) to DGM (Credit), it was observed that, the said loan file had not been submitted to the Risk Management Division within 3 months from the approving for post Loan review mechanism.

- iv) The bank has granted initial grace period of one year for capital repayment from the first loan drawn date of 21 June 2018. However, the initial grace period had been extended several times for capital and interest repayments from June 2018 to June 2022 by stating several reasons.
- v) Although the Board of Directors had granted moratorium facilities to the above project, under the Circular No.5 of 2020 issued by the Central Bank of Sri Lanka, the above loan is not coming under the purview of aforesaid Circular, since the borrower is a foreign company.
- vi) Insurance coverage had not been submitted to the bank for the period after July 2021.
- vii) According to the loan agreement, Debt Service Reserve Account (DSRA) should be opened and maintained in Bank with minimum value of USD 270,000. However, minimum balance in DSRA had not been maintained by the borrower (RPI) and balance as at 31 May 2023 of that account was USD 27,082.23
- viii) According to the loan agreement, lenders should appoint a qualified expert in hotel construction as an independent project officer to monitor the progress of the project. However, lenders had not appointed such kind of person and relied on the progress report of the chartered quantity surveyor who has been appointed by the borrower, RPI Company (Pvt) Ltd.

Economic Reviews published by Maldives Monetary Authority in order to get an idea about the economy of the Maldives while giving special attention to the details on tourism sector. Reasonableness of assumptions such as occupancy rates used in financial forecasts were crosschecked with the data published in Monthly Economic Reviews published by Maldives Monetary Authority. Further, the evaluation was carried out by comparing the Room Rates of similar hotels in Maldives as published in certain hotel websites and from sources such as TripAdvisor. These facts were considered by the Bank when carrying out the independent evaluation. Further, necessary clearances were

Risk Division of the Bank should review the loan within reasonable time period as per the circular instructions.

Initial grace period should be extended on reasonable grounds.

ix) As per available information, no site visit had been carried out by an independent party or officers who are having the required technical skills and competence such as civil engineers. Although there are competent officers with necessary skills in the bank to inspect this construction, site visits from the Bank side have been carried out by officers in the credit division who have no technical skills to observe the quality and completion of construction.

obtained from the NSB Legal Division to cover the legal risk. It is required to comply with the relevant Directions and Circular Instructions published by CBSL.

(iii) Conducting of Post Loan Review Mechanism falls under the purview of Risk Management Division. III. Corporate Finance Division has forwarded the relevant loan files and other related security documents to the Risk Management Division on following days;

27/08/2018,  
19/11/2018,  
07/02/2019,  
09/04/2019,  
10/07/2019,  
18/10/2019,  
23/10/2019,  
13/11/2019

Bank should monitor the renewal of insurance on time by the customers.

The Bank should monitor the buildup of Debt Service Reserve Account as per the loan agreement requirement.

(iv) Noted. All extensions were done with the approval of the Board of Directors.

Bank should have appointed a qualified expert who should be

independent from the borrower without depending on surveyor appointed by the borrower.

(v)The moratorium facilities to the project were granted as a collective business decision by NSB and Peoples' Bank (PB). According to the reply of Director, Bank Supervision Department of CBSL, providing any concession to this type of a facility is a business decision to be taken by the bank upon the customer's requests.

Site visit should be carried out by the officials having the required technical skills and competence.

(vi) Reminders were sent to the client to submit the insurance policy renewal. In response client has provided an indicative quotation slip. Renewed

Insurance Policy is yet to be received. However, the Bank is carrying out continuous follow up on the matter.

vii) RPI has been requested on several occasions to replenish the DSRA up to its minimum balance. The balance available in this A/C was utilized to recover the dues when the loan became overdue.

(viii) Both syndicate lenders decided to proceed with the progress reports submitted by Mohamed Solah, as he is a professional with required qualifications to provide a progress report on a project of this nature.

(ix) Site visits were carried out prior to granting of the facility by NSB and PB officials.

x) As per the Board Minute No. 207/2022 dated 04 July 2022, the Board has decided to appoint an independent advisor to carry out high level of review of RPI facility in different perspectives such as Legal, Engineering, Financial and Regulatory, Credit etc. and to advice the respective board regarding the most prudent cost effective and expeditious course of actions to recover all outstanding sums of RPI (Pvt) Ltd.

- As per Board Paper No. 288/2022, Board of Directors has granted approval to appoint a Global Accounting Firm in Sri Lanka to carryout said assignment by incurring a significant engagement fee of Rs.9,684,400. The Bank has already paid 75 percent of the said engagement fee.
- Said accounting firm has agreed to give the final report of the above project within six weeks from the engagement date. However, despite several requests the said report was not available for the auditor's review until the date of this report. Deputy General Manager (Legal) has informed on 31 August 2023 that the bank is seeking advice from the Attorney General and the instructions from the Board of Directors to release the said report to the audit.
- No evidences were available to the audit to confirm whether the bank has received any support from the said report to identify the current status of the RPI project, Legal and regulatory framework and most prudent ways to recover the outstanding amount of this loan.

The former Board of Directors of the Bank at their meeting held on 15<sup>th</sup> September 2022 decided to engage the services of Pricewaterhouse Coopers (Pvt) Ltd, (PWC), Sri Lanka to carry out a high-level review of the USD 10 Mn syndicate loan granted to RPI in order to enable the Board to make an informed and considered decision to determine most prudent cost effective and expeditious course of action to recover the dues. The Board at its meeting held on 15<sup>th</sup> September 2022 decided to engage the services of the PWC Sri Lanka to carry out the above assignment and to make the

Bank should ensure the recoverability of loans before granting loan. Cost effective and efficient method should be followed to recovery actions. Recommended to release the information as the Auditor-General or

necessary any person payments to them authorized by him as per the payment shall in the milestones and out performance and of pocket expenses discharge of his set out in the duties and functions Letter of be entitled to have Engagement. access to all books, At the Board records, returns and meeting other documents, as (reconstituted per Section 154 (5) Board) held on 9<sup>th</sup> of the Constitution June 2023 it was of Democratic decided not to Socialist Republic proceed with the of Sri Lanka. said assignment and to seek the advice of the Hon. Attorney General (AG) in this regard.

Accordingly, it was referred to the AG on 19<sup>th</sup> June 2023.

PWC released its Financial and Tax Review interim report to the Bank on 7<sup>th</sup> June 2023 and Interim reports on the valuation and the legal and regulatory review reports were placed before the Board at its meeting held on 23<sup>rd</sup> August 2023.

## **PWC's Final Reports**

PWC has forwarded the following final reports by letter dated 12.09.2023 which will be presented to the Board at the next meeting.

- i. Final Report on Financial and Tax Review
- ii. Final Report on Valuation
- iii. Final Report on Legal and Regulatory Review

## PWC Authorization Letters

The Board of Directors at their meeting held on 9<sup>th</sup> June 2023 granted approval to obtain the consent of PWC to share their report with the Hon. Attorney General and the Central Bank of Sri Lanka on a strictly confidential basis.

PWC by letter dated 27.06.2023 agreed to release the interim report subject to the

conditions that a party who is not an addressee of this report to sign a Hold Harmless Letter. PWC has requested NSB to obtain the necessary Hold Harmless Letters from third parties with whom NSB wishes to share this report and also ensure that the contents of the reports are kept strictly confidential. In addition, PWC has also requested for NSB to sign an authorization letter prior to release of this report. This matter was placed before the Board at its meeting held on 12<sup>th</sup> July 2023. NSB sought the consent from PWC to release the Property Valuation Report and Legal and Regulatory Review Report to the Hon. Attorney General. In response, by letter dated 18<sup>th</sup> August 2023 PWC has permitted the Bank to release

the said reports with the consent of the Praxis Law Firm LLP and Sunil Fernando Associates subject to the conditions stipulated therein. The letter specifically requests the NSB to sign the consent letter releasing the PWC, Praxis Law Firm LLP and the Sunil Fernando Associates from having any duty of care towards the recipient and any liability arising thereof. PWC disclaims any contractual or other responsibility to any external supervisory body including Hon. Attorney General of Sri Lanka, Central Bank of Sri Lanka or Ministry of Finance. This matter was presented to the Board at its meeting held on 23.08.2023.

Advice of the  
Hon. Attorney  
General

A consultation to discuss the RPI matter was held with Mr. Susantha Balapatabendi, Additional Solicitor General on 13<sup>th</sup> July 2023. The Attorney General by letter dated 17<sup>th</sup> July 2023 has requested the NSB to provide the information detailed in the said letter as soon as possible.

As instructed by the Board of Directors to seek the advice of the Hon. Attorney General with regard to all matters concerning RPI facility, DGM – Legal sought advice from the Hon. Attorney General for the AG's advice for NSB to sign the consent letter/authorization letters for the purpose of releasing the interim reports to the Hon. Attorney

General,  
Government  
Audit, Central  
Bank and Ministry  
of Finance on a  
strictly  
confidential basis.  
The advice of the  
Hon. Attorney  
General in this  
regard is pending.  
Copies of letters  
dated 12<sup>th</sup>  
September 2023  
are enclosed.

e) The Bank had granted a loan amounting to Rs.12,600,000 to Zaharan Enterprises under the Loan No-603086247060 on 23 September 2019. The outstanding balance and total arrears of installments as at 31 May 2023 were Rs.12,929,827 and Rs.6,155,562 respectively. The above loan has been granted to purchase a house and a property. Following observations are made in this regard.

(i) AGM (Credit) has approved this loan without considering the irregular re-payments of 10 credit facilities stated in the CRIB status report of this borrower.

(ii) The Zaharan Enterprises had provided Business Registration No. WA/11923 dated 10 August 2017 when obtaining the loan. However, the Audit could not find any business registration related to above business under Provincial Department of Business Names Registration and Sri Lanka Bureau of Foreign Employment web site as a business who dealing with supply of manpower to foreign employment and language transaction affairs.

(iii) This borrower had repaid only one (01) installment by 31 May 2023 and final notice regarding auction of property sent to the loan holder by AGM (Recoveries) on 19 July 2022. When the bank had executed parate, the customer has obtained an enjoining order to prevent the Auction on 18 January 2023. However, filing objections before the court

i) Noted. The fact The Bank should  
has been clearly perform proper  
mentioned in the customer  
approval paper evaluations before  
submitted for the granting loans and  
loan. take every  
endeavor to  
recover the loan  
outstanding.

(ii) The copy of

had been delayed till 21 July 2023 as the legal division has failed to file its proxy due to the absence of the Board.

Business Registration Certificate forwarded by the customer has been considered in granting the loan facility.

(iii) Parate action has already been initiated to recover the loan. Auction of the property was scheduled to be held on 19.01.2023. The customer obtained an injunction order to prevent the auction. The Bank filed objections to the injunction on 21.06.2023

### 3.3.2 Card Centre Operation

Audit Issue	Management Comment	Recommendation
<p>a) According to Section 5.6 of the General Direction No. 02 of 2022 dated 28 February 2022 under Payment and Settlement System Act No. 28 of 2005 regarding Operations of the Common ATM Switch (CAS), every CAS member shall be responsible for making regular backups of databases and all its information and data relating to the operations of CAS and</p>	<p>The Card Centre has implemented automated backups for all its automated functions, encompassing areas such as reconciliation and the Card Management System. These backups are diligently handled by the IT division at both the Server and Database levels. However, daily manual tasks, including chargeback</p>	<p>Automated backup procedure for key functions should be maintained by the Card Centre for smooth operation.</p>

establishing and maintaining recovery procedures in the event of system failure or data corruption or loss. However, card center has failed to maintain automated backup procedure for some key functions such as customer refunds, dispute handling, charge backs and reconciliations.

processing, dispute handling, refunds, and additional reconciliation reports, are stored on User PCs. Presently, backups for these tasks are taken manually and saved on external hard drives only. Discussions are currently underway with the IT Division to establish a more formal and secure backup system specifically tailored to the Card Centre's PCs.

### 3.4 Transactions of Contentious Nature

#### Audit Issue

Without considering the opposition raised by the Treasury Representative, the Board had approved the compensatory and fuel allowances for Deputy General Manager (DGM) and above Grades which are higher than the allowances proposed by the Management Committee. Hence, it was observed that the board has not paid their attention to maintain the personal cost of the Bank at a lower level in order to enhance the bank's profitability.

Grade	Existing Allowance (Rs.)	Approved Allowance (Rs.)
GM	Rs.175,000+ Fuel 275 Ltr	Rs.200,000+ Fuel 275Ltr
SDGM	Rs.150,000+ Fuel 200 Ltr	Rs.175,000+ Fuel 225Ltr
DGM	Rs.125,000+ Fuel 225 Ltr	Rs.150,000+ Fuel 225Ltr

#### Management Comment

In terms of section 26 (2) and (3) of the National Savings Bank Act No 30 of 1971 and its amendments, the Board can appoint officers and servants as it may consider necessary for the conduct of the business of the Bank. Further, the salaries and benefits and other conditions of service of the General Manager, other officers and servants shall be determined by the Bank. Further, as per section 2.1 a) of the BHRRC Charter prepared as per the guidelines issued by the Central Bank of Sri Lanka, the committee shall determine the remuneration policy (salaries, allowances and other financial payments) relating to Directors, Chief Executive Officer (CEO) and Key Management Personnel of the Bank, other than the remunerations determined by

#### Recommendation

It is required to ensure the Bank's profitability when delivering personnel benefits to its employees.

the Collective Agreement. Accordingly, the increase of Compensatory and Fuel Allowances to Grade 1 and above staff has been recommended by BHRRC and approved by the Board of Directors.

### 3.5 Idle or underutilized Property, Plant and Equipment

Audit Issue	Management Comment	
<p>a) The Bank had obtained a land with an extent of 38.8 perches in 2008 from Urban Development Authority for 50 years period. Although the management had decided to develop a new building in this land, any construction activities had not been started yet.</p>	<p>This land was leased in 2008 for a period of 50 years. In November 2009, the bank had a discussion with UDA at which it was transpired the said land with a land of which extent 106.69 perches adjoining to the bank's head office building to resettle the encroaches of that land at the bank's leased land. Due to this reason the bank has not engaged in any development project on the leased land since then.</p> <p>However, the encroaches of the said land were provided house elsewhere in 2020. Thereafter, due to Covid-19 outbreak and the prevailing economic condition of the country it was compelled to postpone the development project indefinitely.</p>	<p>Idle assets should be utilized for effective purposes.</p>
<p>b) Although the Bank had rented out 4 storied building for the use of Pettah Branch since June 2019, two floors of the building with an extent of 4,629 square feet have remained idle without being used. The Bank had paid Rs.75.6 million as rent expenses up to May 2023.</p>	<p>The building owner of the previous location has insisted on vacating the building and the bank has been searching for a suitable location in Pettah for nearly 1-year period.</p> <p>The old building was planned to be renovated completely and due to our delay, the project was postponed several times.</p>	<p>Idle assets should be utilized for effective purposes.</p>

Lastly, the building owner informed to pay any liquidity damages if the bank further delay evacuating the building.

At that time current building was proposed and it was the only suitable location to the operations of the Pettah branch. Even though the extent of the building excessive to the requirement, the management was compelled to grant approval to the proposed location by considering the situation. Apart from extent of the building, the location is highly visible with the parking facility, location in the heavy foot traffic area. The building has a single entrance, and the stare way runs through the building for all three floors.

However, the bank uses the 3<sup>rd</sup> & 4<sup>th</sup> floors to conduct training and seminars and part of it is being used for storage purposes by the surrounding branches at the moment. Since all floors are made in timber structure 100 years ago, it is in danger to use for heavy loads on the upper floors.

- c) Kottawa branch had obtained the 1<sup>st</sup> floor of the existing building at a monthly rental of Rs.200,000 for a period from August 2020 to August 2025 (5 years). Though at the beginning, the Branch had paid Rs.3,600,000 as a rent advance (18 rentals), it had not used that floor up to now due to delay in refurbishment.

The upper floor of the Kottawa branch was hired with the view of expansion of the existing branch due to the congested condition, on the recommendation given by the branch operations.

The agreement was signed by the two parties during the Covid-19 outbreak and the building owner got delayed handing over the building due to the lock down and material shortage prevailing in the country. Later, the premises division estimated the upper floor

Idle assets should be utilized for effective purposes.

expansion project which was amended several times by the management due to the cost of the project was doubled to the previous prices.

However, as per the direction given by the CBSL, the bank has postponed all the development projects until the bank came back to sound financial stability. Until such period the Manager-Kottawa branch was advised to use the space for a useful purpose without any development work

### 3.6 Human Resources Management

Audit Issue	Management Comment	Recommendation
<p>(a) At the end of December 2022, the board approved cadre of the Bank was 5408 and actual cadre was 4489. At the end of May 2023, the actual cadre has reduced to 4454. Accordingly, 974 number of vacancies and 20 number of unapproved excess staff were observed. Following observations are made in this regard.</p> <p>i) Out of the 883 of Executive Staff Cadre, 184 or 21 per cent was vacant which includes 02 Deputy General Managers, 07 Assistant General Managers, 04 Chief Managers, 51 Senior Managers, 54 Managers, and 62 Assistant Managers.</p> <p>ii) Out of the approved cadre of 1593 of Supervisory Grade (grade III-III and IV), 509 numbers of vacancies were existed as at the end of May 2023.</p>	<p>Vacancies in the approved cadre is filled by way of recruitment and promotions. Following are the present update of Recruitment and Promotions.</p> <p><u>Filling vacancies by recruitment</u> Recruitments have been withheld as per the instructions given by the Director Bank Supervision by her letter dated 23.05.2023 until the Bank starts making profits and meets all regulatory requirements on capital and liquidity.</p> <p>Further, BHRRC has cancelled the recruitment for the Post of Officer Trainee Gr. III-III.</p> <p><u>Filling vacancies by promotions</u> Promotions to Grade I granted. Applications called for AGM (Non-Banking Stream).</p>	<p>The Bank should ensure that the required member of staff and required positions are occupied for smooth running of the banking operations.</p>

iii) Out of the total approved cadre of 5,408, 54 percent was relevant to the Non-Executive (Grade V and VI) and Minor (Grade VII) Grades. Out of that, 281 and 38 were vacant employees and contract basis employees respectively.

iv) The bank has recruited employees for 20 excess positions which has not been approved by the Board of Directors.

Applications are called for promotion to Grade II and III-I. Written examination and interviews completed for the promotion to Grade IV.

HRD Division has prepared a cadre plan of the staff requirements of divisions and the branch sector and forwarded for the approval of the BHRRC. The excess positions will be adjusted accordingly.

Designation	No. of Recruitments
AGM (Projects & Engineering)	01
Chief Manager (BMD)	01
Chief Manager (IT-E-Banking Unit)	01
Chief Manager (Training)	01
Chief Manager (Credit)	01
Office Manager (Chairman's Division)	01
Asst. Secretary to BOD	01
Asst. Manager (Divisions)	06
Asst. Manager (Administration)	01
Asst. Manager (IT)	01
Receptionists	04
Motor Mechanic	01
Total	20

(b) In December 2021, the Bank has recruited the Chief Legal Officer (DGM Grade) contrary to the general recruitment procedure of the Bank by

The post of Chief Legal Officer was advertised in Sunday Observer and Daily News on 24.01.2021 and 25.01.2021

Recruitments should be made by complying with the conditions stated in the approved

offering unreasonable benefits such as removal of probation period, placing the salary scale above the initial step, non-verification of original certificates and provision of six months extension to assume duties at the request of applicant. Thus, more potential applicants had been limited through the eligibility criteria set for the work experience in the legal field and the age limit.

respectively. In response, 16 applications were received. Further, applications were invited from the eligible internal candidates by DGM (HRD)'s instructions letter No. 05/2021 dated 22.01.2021 and in response 03 applications were received. However, out of the aforesaid 19 applicants only 01 applicant i.e., Ms. K D Jayathilake was eligible as per the scheme of recruitment. Most of the applicants did not possess the 5 years' of Senior Managerial experience in the capacity of Head of Legal/AGM – Legal/Chief Manager – Legal at a reputed financial institution as required by the approved scheme of recruitment.

Accordingly, Board of Directors at its meeting held on 31.03.2021 granted approval to recruit Ms K D Jayathilake to the post of Chief Legal Officer (DGM Grade).

Further, When the Bank is recruiting from outside for specialized positions, the applicants usually bargain for privileges. In such situation, the Board of Directors is empowered to decide on the salary step in order to be competitive and to recruit the right candidate.

Scheme of Recruitment (SOR) for relevant post.

(c) As per the Board paper number 40/0658/2015 dated 09 December 2015, Senior Manager- Legal had been recruited (on Contract Basis) for the purpose of strengthening the legal division of the Bank. However, by the Letter No. 385/2016 dated 11 July 2016 of Senior Deputy General Manager, said officer had been assigned to the Kandy

Senior Manager- Legal had been recruited (on Contract Basis) for the purpose of strengthening the legal division of the Bank. Accordingly, with the approval of the Board of Directors, the said position was advertised. Out of the 6 applicants applied for the said position, 4 applicants were

Allocation of staff should be made as optimizing the objectives expected from such position.

Branch to perform the activities related to the granting of housing loans. Though the above officer had been recruited for the legal division, the purpose of this recruitment was not achieved due to lack of professional experience which was noted by the AGM(HR). Details relating to the recruitment such as educational and professional qualifications of all applicants, experience and attendance list of participants for the interview etc. had not been maintained by the Bank.

- (d) As per the Board Human Resource and Remuneration Committee (BHRRC) minute dated 25 October 2021 (BHRRC Paper No. BHRRC/2021/55) and board minute dated 09 December 2021 (Board Paper No.- 419/2021), from the outsourced employees, the Bank has recruited 24 employees under contract basis and 27 employees under permanent basis to the Bank's cadre. Applications for all of these posts had not been called through an open newspaper advertisement.

called for the interview. Marks given for the educational and professional qualifications, experience, performance at the interview of all applicants, were forwarded for the Board of Directors as an attachment at the time of recruitment. However, since the HRD Division has not maintained an attendance sheet for the applicants attending for a promotion interview, actions will be taken to implement the same.

As a solution to a long-standing grievance, Board of Directors at its meeting held on 17.09.2015 granted approval to absorb all outsourced personnel on contract basis having considered the service on outsourced basis as at 26.03.2015 prior to 2019.

Thereafter, as per the General Manager's Circular No. 902/2017 dated 08.03.2017, employees on contract basis for a minimum of two years were considered for absorption into the permanent cadre subject to a job test and an interview.

Accordingly, the Bank has already absorbed the outsourced employees in the categories of Office Assistants, Typists, Telephone Operators, Call Centre Contact Associates, A/C Technician, Electrician, Motor Mechanic, Receptionist and Drivers.

Since there were few employees remaining in the above categories who were to be absorbed into the permanent cadre, a paper was

Applications for relevant posts should be called through open advertisements for competitive recruitments.

submitted to the Board as the Bank had to take a decision on remaining employees who were on outsourced/contract/trainee basis. Accordingly, a paper was submitted stating all such employees to consider them for absorption into the permanent cadre.

- (i) As per the Scheme of Recruitment (SOR) approved on 09 July 2020, written examination and interview should be conducted when recruiting Office Assistants. However, contrary to the SOR, 03 employees had been recruited without conducting written examination.

Out of the 09 employees approved by the Board on 09.12.2021, 06 employees on outsourced basis were absorbed into contract basis in 2018 and 2019 before the COPE recommendation, following the procedure explained in c.) above. They have faced the job test after completing 02 years contract period and therefore, Board of Directors on 09.12.2021 granted approval to absorb them to the permanent cadre subject to a probation period of 06 months. The remaining three employees were recruited on outsourced basis following a requirement at the Chairman's Division in order to maintain confidentiality and also to address an urgent staff requirement in the Eastern Region.

Recruitments should be made by complying with the conditions stated in the approved Scheme of Recruitment (SOR) for relevant post.

- (ii) Seventeen (17) employees had been recruited to the Bank as "Trainees Call Center Associates". Out of them two employees who have no minimum educational qualifications were absorbed to the permanent cadre by mentioning that "there is no SOR at the time of outsourcing them in 2018". However, it was observed that the SOR had been approved by the

17 Call Centre Contact Associates were deployed on outsourced basis and later absorbed into the Bank's permanent cadre. Out of the 17 Call Centre Contact Associates, 02 of them were hired on outsourced basis in 2018 and were absorbed into the permanent cadre on completion of two-year contract period and passing the job test as per the same procedure

Recruitments should be made within the minimum qualifications specified in the approved SOR.

Board on 07 September 2018 before recruiting them under contract basis. Another Six (6) employees who have joined at the end of year 2020 did not have the minimum qualifications as per the approved SOR and they had not been absorbed to the permanent cadre. However, Board has granted approval to absorb them in to the permanent cadre after completing required qualification within two years and completing 02 years' contract period. It is questionable that why the board has given 02 years' period to complete the minimum qualification to unqualified people without attracting the qualification completed candidates.

adopted for other outsourced staff as explained in c.) above.

This procedure has been commonly adopted in the Bank when absorbing outsourced personnel into Bank's permanent cadre.

(iii) Six (6) numbers of people had been recruited as Drivers under contract basis during the years of 2020 and 2021. It was observed that CVs of two drivers had been forwarded to the chairperson through General Manager without calling application through proper method.

The existing Schemes of Recruitment for the Post of Driver has been reviewed and will be forwarded for the approval of the BHRRC/Board of Directors.

Recruitments should be made by complying with the conditions stated in the approved Scheme of Recruitment (SOR) for relevant post.

(iv) As per the SOR of typists, examination should have to be conducted to test whether candidates have the speed of shorthand of 70 w.p.m. and speed of typewriting of 25 w.p.m. Even though, twelve employees who passed the initial job tests had been absorbed to the permanent cadre before conducting above examination. one typist who failed the initial job tests was allowed to work under contract basis until sit for the exam and obtain a pass mark

The service of the remaining typist who was not successful at the job test has been terminated w.e.f. 01.12.2022 i.e. on the expiry of the five year contract period.

Recruitments should be made within the minimum qualifications specified in the approved SOR.

to be considered for absorption into the permanent cadre. It is questionable of giving such employee an interim period to complete the required qualifications.

(v) To attracting competitive candidates, the Bank should prepare a SOR for every position which includes Educational Qualification, Experiences, Age Limits, Terms and Conditions, Selection Method etc. However, two receptionist and trainee IT technical had been recruited without SOR for such positions.

Schemes of Recruitments have been prepared for the Posts that do not have a scheme and needs review in the existing scheme and the same will be forwarded for the approval of the BHRRC/Board of Directors

Approved SOR should be available for every approved cadre position.

(e) The Bank has decided to grant foreign leave to 92 staff since 2021 without considering the workforce availability to continue the bank operations without any difficulties. Details are given below.

Year -----	No. of Staff -----
2021	04
2022	29
2023 - Until suspension of foreign leave on 02/06/2023	23
2023-pending approvals after suspension of foreign leave	36
	<b><u>92</u></b>

Since there is a Circular in the Bank, permitting employees to travel abroad on no-pay leave for studies / employment, the employees have requested for no-pay for the said purpose due to the economic crisis in the country.

Although this has been a concern to the Bank, the Bank did not prevent from granting no pay leave for employees as the other two State Banks too granted approvals on the same basis.

Further, these employees have been granted approval to travel abroad subsequent to the recommendations of the HRC, approval of the BHRRC, Ministry of Finance and signing a Bond and Agreement with the Bank.

Bank should approve foreign leaves without any disturbance to continuation of banking operation.

(f) (i) There was no any database available in the bank to identify the foreign leaves granted before 2021.

i). During the period from 2015 to 2021 only a few members of employees had traveled abroad on

Updated employee database should be available with the

no-pay leave for study bank with all /employment purposes. information.

Therefore, a separate database has not been maintained. However, all the documents pertaining to their travel abroad are filed in their personal files.

Furthermore, leave management in the Bank was manually handled during the said period and it was not linked to the existing HR system and salary systems. Therefore, system generated reports could not be obtained.

Due to the prevailing crisis in the country, the number of requests on travel abroad on no-pay leave has been drastically increased. Thus, a register has been maintained from the year 2021.

(ii) Out of above 92 employees, 55 percent or 51 employees are under Executive Level Category including an Assistant General Manager (Key Management Personal).

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(iii) According to GM's Circular No. 739/2009 dated 24 March 2009, it was stated that there is no category of leave called 'no-pay leave' to which an employee is entitled. Further it was stated that no-pay leave is granted in very exceptional situations with the Bank's permission.

However, during last two- and half-year period, the bank has decided to grant permission to above 92 employees notwithstanding their reasons for the no-pay leave. Out of them, 46 employees decided to get leave for higher educations, 43 employees for employments and other 3 employees for other reasons.

(iv) When granting no-pay foreign leaves, the Bank has considered no-pay period after deducting carried forward privilege leave from previous year and current year privilege leave without granting no-pay from the date of departure. The days deducted from no-pay leave is ranging from 02 to 92 days. Further, the audit could not find any internal circular regarding such deduction.

(iii). Under Section 17 of GM's Circular No:739/2009, a confirmed employee with a minimum of 04 years' service in the Bank may be granted no-pay leave to travel abroad for study/employment purposes for a total period not exceeding 05 years in his/her career in the Bank. Accordingly, the Bank had granted no-pay leave to travel abroad.

Bank should approve foreign leaves without any disturbance to continuation of banking operation..

(iv). When requesting for long term no-pay leave, employees always request to avail their leave entitlement initially to cover a part of their travel abroad period and to grant them no-pay leave for the balance travel abroad period. Therefore, un-availed privilege leave of the current year and previous year are utilized to cover a part of their travel abroad period. Even though the staff had been granted approval to travel abroad on no-pay leave as requested by them, some employees had travelled abroad on a later date due to delay in receiving the visas. Thus, the un-availed privilege leave had been utilized to cover the part of their period effective from the date they travel.

No-pay leave should be approved and granted from the date of departure.

(v) Although foreign leaves granting period of two officers bearing EPF numbers of 6450 and 7799 were ended on 20 December 2021 and 03 July 2023 respectively, they had not assumed duties up to the date of audit on 15 July 2023 and loans amounting to Rs.2,650,000 and Rs.4,100,000 had been granted to them respectively and was unable to recovered by the bank. Outstanding amount of those loans as at 15 July 2023 were Rs.2,438,938 and Rs.3,785,909 respectively.

(v). **EPF No: 6450**

She had been granted leave for the period from 20.12.2021 – 19.06.2023.

The aforesaid employee tendered resignation with effect from 20.06.2023, the date she was due to report to duty. At the time of granting approval for travel abroad on no-pay leave, she had only obtained the staff housing loan. Her terminal dues have been released after deducting the loan arrears instalments. Having recovered the arrears amounts from the terminal dues, the Recovery Division will take action to recover the balance loan amounts as per the terms and conditions of the said loans.

Actions need to be taken to recover the dues from respective employees.

**EPF 7799**

The said officer has been granted leave for the period from 03.01.2022 – 03.07.2023.

He was resigned from the Bank's service w.e.f. 04.07.2023.

We have made inquiries from AGM (Recoveries) on 28.08.2023, and we were informed that the said employee has paid up to date for the loans bearing numbers 603086319875 and 603086300342 without any arrears.

His terminal dues are yet to be released. Resignation will be accepted once the employee settles his loans.

(g) (h) Human Resource Division of the Bank had taken considerable time period for conducting disciplinary inquiry procedures and taking disciplinary actions against frauds

The Audit Division of the Bank conducts a preliminary investigation and forwards the investigation report to the HRD Division regarding acts of

Bank should expedite the procedures of conducting disciplinary inquiry and taking

done by the bank's staff. It was observed that Human Resource Division has taken period ranging from 6 to 25 months to issue a charge sheet after receiving the initial investigation report on 15 officers from the Internal Audit Division.

misconduct committed by Bank employees. The General Manager / CEO grants approval to serve charge sheets against the respective officers, the Audit Division is informed to prepare the draft charge sheets. Draft charge is submitted to the Legal Division to screen and confirm the charges in said charge sheets, and submitted to the HRD Division. The respective charge sheets are issued to the relevant accused officers.

disciplinary actions against staff members.

Subsequently, the said charge sheets are served to the accused officers and formal disciplinary inquiries are conducted against them.

At the conclusion of the formal disciplinary inquiries, punishments are imposed on responsible accused officers with the approval of the Disciplinary Committee based on the recommendation of the inquiry officer. Accordingly, this whole process takes a considerable duration of time.

(vi) It was observed that minor punishments had been given by the Human Resource Division for serious nature frauds under the Sub Section "a" of the Disciplinary Code of the bank which may lead to increase the frauds done by the bank's staff due to reducing fear on punishment. Following instances were observed.

Disciplinary action should be straightforward which leads to minimize frauds done by the staff members.

Designati Incident  
on

The relevant officer who was attached to Badulla Branch of the Bank had been interdicted from the bank's service. Subsequent to issuing a charge sheet, he had

<p>Officer (grade iii-iii) at Badulla branch</p>	<p>The officer had been dismissed since 21 March 2013 due to 9 frauds including 5 serious nature frauds under the Disciplinary Code (DC) of the bank and after conducting another disciplinary inquiry he was release from all 9 frauds in 19 October 2017. Since 08 October 2020, he was reinstated in the service even after he has involved to another fraud by incurring a loss of Rs. to 6,834,500 .the Bank</p>	<p>been dismissed from the bank’s service upon been proven guilty of the charges against him. Following an appeal made by the relevant officer against the aforesaid disciplinary order, a re-inquiry had been conducted based on the decision of the Board of Directors, and he had been reinstated in the Bank’s service after been exonerated from all charges at the re-inquiry. However, another charge sheet had been issued against him on account of another misconduct relevant to pawning advances of Badulla Branch. Owing to being proven guilty of 13 charges out of 15 in the said charge sheet. Approval has been granted for the said officer to retire. However, his terminal dues have not been released to him as of yet.</p>
<p>Staff Assistant II worked at cash counter in the Tissamah arama Branch</p>	<p>The officer had committed serious nature frauds under Disciplinary Code (DC) in 21 January 2019 and had been demoted to Staff assistant I. However, subsequently she has done another series nature frauds while working at Hakmana Branch as per the investigation done on 8 June 2023.</p>	<p>The said officer has been proven guilty of the charges mentioned in the charge sheet issued against her regarding obtaining the cash from her cash counter fraudulently while serving at Thissamaharama Branch. The said officer had been reinstated in service. Said officer had been involved in another misconduct while serving at Hakmana Branch. As such, she has been interdicted and a formal disciplinary inquiry has been commenced. following the issuance of a charge sheet.</p>

Executive (grade - iii –iii) at Kilinoch chi branch

The officer had done 6 serious nature frauds relating to the pawning articles in 2019 and Bank had demoted this officer to Executive (grade iv) and defer the salary increment for a one year. Even though, the dismissal from the service is warranted to given the gravity of relevant charges, by considering her past service record, the management has decided to reinstate in service with immediate effect.

Even though the said officer had been proven guilty of all charges in the charge sheet issued against her at the formal disciplinary inquiry, the inquiry officer by his report has recommended to impose a severe punishment such as demoting from the post / the grade instead of dismissing from the service considering the facts submitted by the relevant officer to the Inquiry Board.

Having taken the said facts also into consideration, the relevant officer had been re-instated in service subject to the following punishments with the approval of the Disciplinary Committee.

Non-entitlement to any salary or allowances for the period of interdiction.

#### 4. Accountability and Good Governance

##### 4.1 Annual Action Plan

###### Audit Issue

Some of targets in the Action Plan-2022 had been postponed or some of targets had been retained until the completion of the Core Banking System. Some important targets had become unrealistic until the completion of Core-Banking System. Such as Automation of data collection for Operational Risk Management Function, Automation of General Ledger, Financial Reporting, Budgetary Process and Business Intelligence Process Improvements, Amalgamating Postal Banking System with Core Banking System, Migration of Pawning System to Oracle & Software Re-writing etc

###### Management Comment

As per core banking timeline these activities were incorporated to the Action Plan. However, due to the delay in implementing the same these activities were postponed.

###### Recommendation

Action plan should include achievable target which aims to achieve during the year.